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No. 86-1109

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In The  
**Supreme Court of the United States**

October Term, 1986

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KATHRYN B. CELAURO  
as successor in interest to

MARTHA B. OLSEN, COMMISSIONER OF REVENUE,  
STATE OF TENNESSEE,

*Petitioner,*

vs.

MIDLAND BANK & TRUST COMPANY, ET AL.,

*Respondent.*

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ON APPEAL FROM THE SUPREME COURT  
OF TENNESSEE

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MOTION FOR LEAVE TO FILE BRIEF AS  
AMICUS CURIAE

AND

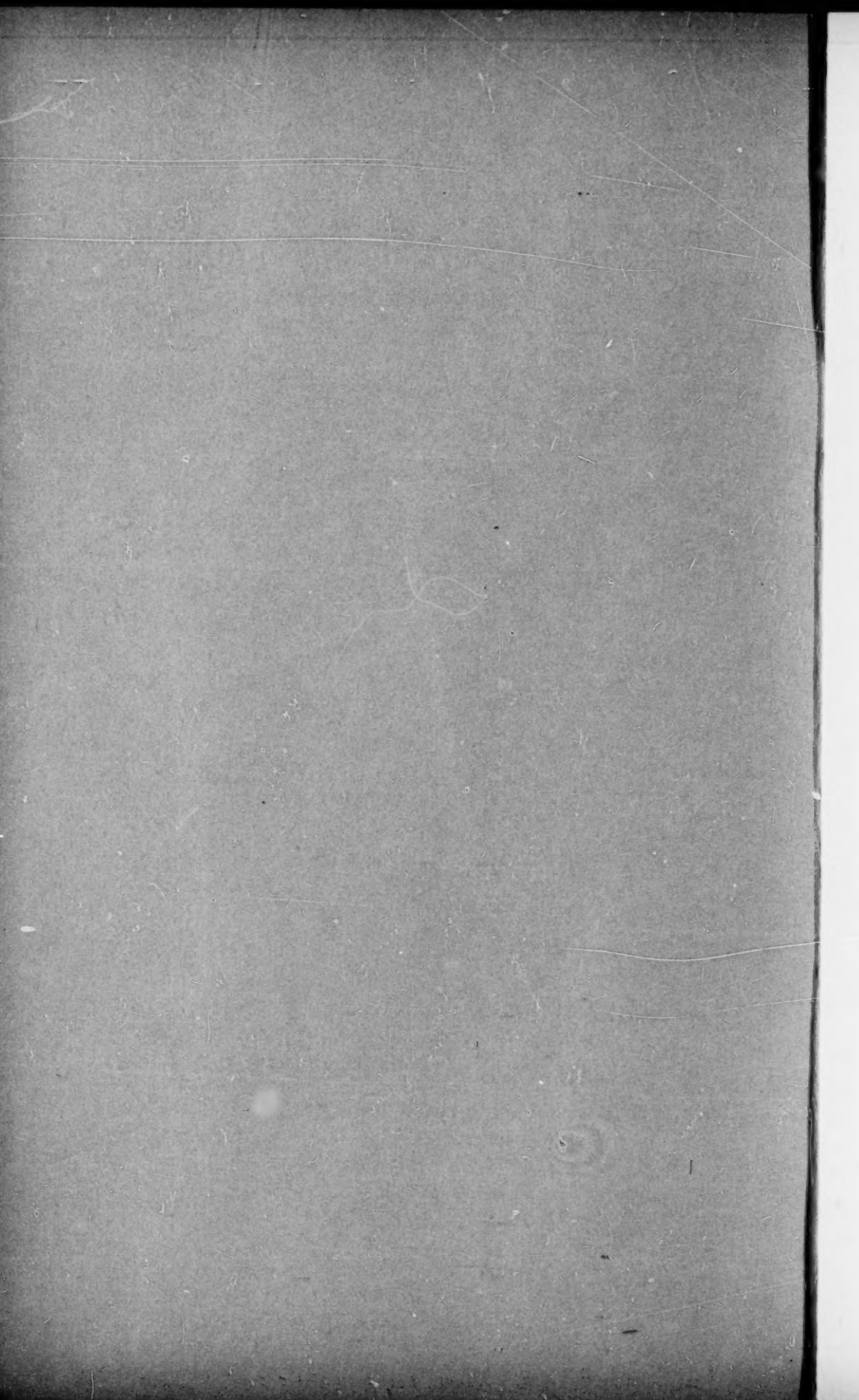
BRIEF OF MULTISTATE TAX COMMISSION AS  
AMICUS CURIAE

IN SUPPORT OF PETITION FOR A  
WRIT OF CERTIORARI

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Pursuant to Rules 36 and 42 of the Rules of the United States Supreme Court, the Multistate Tax Commission (MTC) respectfully moves for leave to file the attached brief as *amicus curiae*.<sup>1</sup> The brief is conditionally attached to this motion and lodged herewith. In support thereof, the MTC states:

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<sup>1</sup> The Appellees have refused to consent to the filing of the attached brief as *amicus curiae*.

## **SPECIAL INTEREST OF THE MULTISTATE TAX COMMISSION**

The MTC is the official administrative agency of the Multistate Tax Compact (Compact) and files this motion on behalf of itself and its member states. Its interest in promoting 1) uniformity and compatibility in tax administration systems and 2) fair and reasonable taxation reflects the interests of all states upon which the decision herein may have an impact, including its member states.

It is important to the states that the Court accept this case and render a decision that will protect both state revenue bases and the interests of the states in uniformity and in fair and reasonable taxation. The MTC is particularly concerned that the decision of the Tennessee Supreme Court would establish a precedent for rulings that banks which invest in federal obligations will be able to immunize from state taxation vast amounts of income which has no relationship whatsoever to either the federal obligations or the income from such obligations; that the effect could be to immunize all bank income from taxation in some states; and that a further effect could be to create other types of tax shelters in related areas, thereby creating a detrimental impact on state revenues that is not initially apparent in this litigation. The MTC is in a unique position to present the issues from the perspective of the states as a group.

The attached brief of the MTC as *amicus curiae* demonstrates that the questions arising in the case are substantial and should be considered by this Court.

**CONCLUSION**

The MTC urges the Court to grant its motion for leave to file the attached brief as *amicus curiae*.

Respectfully submitted,

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## **QUESTIONS PRESENTED**

Whether 31 U.S.C. § 3124(a) requires that gross interest income produced by federal obligations be deducted from a bank's total net income (produced by investments in federal obligations and by other operating activities) in order to arrive at taxable income for state income tax purposes, thereby exempting from state taxation large amounts of bank operating income not related to the exempt federal obligations or to the income derived therefrom.

Whether Tennessee really treats income from federal obligations comparably with income from Tennessee obligations in exempting both from the application of its excise tax.

Whether, if the Court holds that Tennessee does not treat the two types of obligations comparably, that conclusion should lead to an expansion of the federal benefit beyond the intended exemption of interest income from federal obligations.

## **PARTIES TO THIS PROCEEDING**

The parties to this proceeding are set forth in the Petition for Writ of Certiorari.

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**OPINION BELOW**

The opinion below is reproduced at Appendix E of  
the Petition for Writ of Certiorari.

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**JURISDICTION**

This Court has jurisdiction pursuant to 28 U.S.C.  
§ 1257(3).

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## CONSTITUTIONAL AND STATUTORY PROVISIONS

The constitutional and statutory provisions involved are reproduced in the Petition for Writ of Certiorari.

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### INTEREST OF THE MULTISTATE TAX COMMISSION

The MTC is the official administrative agency of the Multistate Tax Compact (Compact) entered into by 18 states and the District of Columbia as full members and by 10 states as associate members.<sup>2</sup>

The Compact states its purposes to be to:

“1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

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<sup>2</sup> The legislatures of eighteen states plus the District of Columbia have enacted the Multistate Tax Compact, thereby making those states and the District regular members of the MTC. The eighteen states are Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington.

One state, Alabama, has enacted the Compact subject to congressional legislative consent. Pending either enactment of such consent or the state legislature's removal of such consent as a condition to its enactment of the Compact, Alabama is considered to be an associate member state.

Nine other states are associate member states at the request of their respective governors. Those states are: Arizona, Georgia, Louisiana, Maryland, Massachusetts, New Jersey, Ohio, Pennsylvania and Tennessee.

"2. Promote uniformity of compatibility in significant components of tax systems.

"3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

"4. Avoid duplicative taxation."

It is important that the decision herein protect both state revenue bases and the interests of the states in uniformity and in fair and reasonable taxation. The MTC is particularly concerned that the decision of the Tennessee Supreme Court would establish a precedent for rulings that banks which invest in federal obligations will be able to immunize from state taxation vast amounts of income which has no relationship whatsoever to either the federal obligations or the income from such obligations; that the effect could be to immunize all bank income from taxation in some states; and that a further effect could be to create other types of tax shelters in related areas, thereby creating a detrimental impact on state revenues that is not initially apparent in this litigation. The MTC is in a unique position to present the issues from the perspective of the states as a group.



### **STATEMENT OF THE CASE**

This case involves the constitutional requirement, as reflected in 31 U.S.C. 3124, that federal obligations be exempt from taxation by the states except in the case of a nondiscriminatory franchise tax. The Tennessee franchise tax here in question has been declared to be discriminatory

by this Court in *Memphis Bank and Trust Co. v. Garner*, 459 U.S. 392 (1983).

That decision left Tennessee with the problem of determining how to arrive at the constitutionally acceptable result of excluding the proper amount of income from its taxable base. That problem is complicated by the fact that Tennessee "piggybacks" on "federal taxable income" as shown on the bank's federal income tax return. "Federal taxable income" includes net interest income from federal obligations, which is gross income less applicable expenses. Tennessee, in determining Tennessee taxable income, starts its calculations with federal taxable income. From federal taxable income, it excludes the amount of net interest income from federal obligations.

But the bank insists that Tennessee must exclude not the net interest income from federal obligations, which is all that was included in federal taxable income in the first place, but the gross interest income from federal obligations.



## REASONS FOR GRANTING THE WRIT

### 1. **Effective and Fair State Taxation Dictates that Banks Pay their Fair Share of Tax on Non-Exempt Income.**

The result of the type of calculation advocated by the bank would be that much income other than interest income from federal obligations would be exempted from taxation by Tennessee. Thus, the exemption for income from federal obligations would have created an immunity from state taxation for virtually all bank income.

In *First National Bank v. Bartow County Tax Assessors*, 470 U.S. 583, 597 (1985), this Court stated “The tax exemption required by the Constitution and § 3701 is not a tax shelter”.<sup>3</sup> While that decision pertained to a property tax, its philosophy is perfectly applicable here. There, this Court said that, “if banks are allowed to deduct from their assets both federal obligations and the liabilities fairly chargeable to those federal obligations, their ownership will shelter taxable income.”<sup>4</sup> To paraphrase that statement with respect to the franchise tax in question, “If banks are allowed to deduct from their net taxable income both net interest income from federal obligations and the liabilities fairly chargeable to that income, their ownership will shelter taxable income”.

It is significant that this Court relied upon three income tax cases to support its decision in *Bartow*. They were *Denman v. Slayton*, 282 U.S. 514 (1931), *U.S. v. Atlas Insurance Co.*, 277 U.S. 508 (1928), and *Helvering v. Independent Life Ins. Co.*, 292 U.S. 371 (1934). The *Bartow* Court noted that, in *Denman*, it had “upheld provisions of the Revenue Act of 1921 that allowed taxpayers to exclude from gross income interest received on state or municipal obligations, and to take a deduction for interest paid on indebtedness, *except* interest paid on indebtedness incurred or continued to purchase tax-exempt obligations.” (emphasis in original).

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<sup>3</sup> Section 3701 of the Revised Statutes (31 U.S.C. § 742) was replaced “without substantive change” in the 1982 reformulation of Title 31 of the United States Code by 31 U.S.C. § 3124. See n. 1 of *First National Bank v. Bartow County Tax Assessors*, 470 U.S. 583 (1985).

<sup>4</sup> *First National Bank of Atlanta v. Bartow County Tax Assessors*, 470 U.S. 583, 595 (1985).

The position of the taxpayer in *Denman* was almost identical to that of *Midland* in that that taxpayer, like the bank here, was maintaining that it should be allowed both an exemption for the interest received on tax-free obligations and a deduction for the interest paid. If tax exempt income is to be required "to pay its way", as was decided in *U.S. v. Atlas Life Ins. Co., supra*, then surely, the bank here must not be allowed to exclude from gross income interest received on federal obligations, and to take a deduction for interest paid on indebtedness incurred or continued to purchase tax-exempt obligations.

**2. Tennessee Has Cured the Constitutional and Statutory Infirmary Which This Court Struck Down in Memphis Bank.**

The Constitutional and Statutory infirmity which this Court struck down in *Memphis Bank* was that Tennessee included, in the taxable income base of its franchise tax, net interest income from federal obligations while excluding therefrom gross income from Tennessee obligations. By definition, net income consists of gross income less applicable expenses; and gross income consists of net income plus applicable expenses. The net income which was previously included in the Tennessee taxable income base, therefore, consisted of gross interest income from federal obligations less applicable expenses. (The manner in which the applicable expenses are to be determined remains a matter of dispute between the parties; should this Court agree with the contentions of the MTC that the applicable expenses should be disallowed, a remand to the lower court would enable that court to rule upon the fairness of the calculations proposed by the parties for the purpose of determining the extent of the expenses to be



disallowed.) By now excluding the expenses applicable to the interest income from federal obligations, Tennessee has excluded the gross interest income from those obligations: the exclusion of the net income from the federal taxable income (which had been included in Tennessee taxable income via federal taxable income) plus the applicable expenses constituted the exclusion of the gross interest income from federal obligations.

Having excluded from its taxable income base the gross interest income from the federal obligations, Tennessee has satisfied the 31 U.S.C. § 3124(a) requirement that it exempt federal obligations.

**3. No Discrimination Issue Is Before This Court in This Case.**

By satisfying the exemption requirement of 31 U.S.C. § 3124(a), Tennessee has eliminated any constitutional question in the case concerning discrimination. As stated therein, "The exemption applies to each form of taxation . . .", not to each form of exemption. The federal concern is to protect federal obligations from taxation. If, in this case, Tennessee has succeeded in excluding from its taxable income base the gross interest income from the federal obligations, the entire federal requirement has been satisfied; and there exists no reason to look beyond the exemption to determine whether or not Tennessee grants an even more generous exemption to some other type of income.



**4. Tennessee Grants No Greater Exemption To Its Own Obligations Than It Does To Federal Obligations; Thus, No Discrimination Remains.**

Tennessee exempts from its taxable income base the gross interest income from Tennessee obligations. We have established above that it also exempts from its taxable income base the gross interest income from federal obligations. Thus, the two types of income are treated exactly alike. Therefore, even if the nondiscrimination requirement were to be applied to the exemptions herein, Tennessee should still prevail.

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**CONCLUSION**

The member states of the Multistate Tax Commission, as well as many other states, are deeply concerned that the exemption in 31 U.S.C. § 3124(a) not be misinterpreted to expand an exemption for federal obligations so that it immunizes from state taxation additional types of income to which the exemption was never meant to apply.

We urge this Court to grant the Petition for Writ of Certiorari herein.

Respectfully submitted,

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